

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:NER:PEN:PHI:TL-N-4035-00
RHGannon

date: July 10, 2000

to: District Director, Pennsylvania District
Castell Abner, Jr., Group Manager, E:1801
Orville R. Surla, Internal Revenue Agent

from: District Counsel, Pennsylvania District, Philadelphia

subject: [REDACTED]

EIN [REDACTED]

THIS DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANY ONE OUTSIDE IRS, INCLUDING THE TAXPAYER INVOLVED. LIMIT USE OF THIS DOCUMENT TO THOSE WITHIN THE SERVICE WORKING ON THIS CASE. THIS DOCUMENT CONTAINS "RETURN INFORMATION" AS THAT TERM IS DEFINED BY I.R.C. § 6103(b)(2) AND THE DISCLOSURE THEREOF IS PROHIBITED EXCEPT AS AUTHORIZED BY THE INTERNAL REVENUE CODE OF 1986.

Reference is made to your memorandum of July 6, 2000 and to the questions stated therein. According to your memorandum, the taxpayers reported \$[REDACTED] in gross income and Schedule C gross receipts on their [REDACTED] joint return. Subsequent to the filing of the taxpayers' [REDACTED] return, the Pennsylvania Service Center granted the application of the taxpayers' corporation to be taxed as a Subchapter S Corporation for [REDACTED] and refunded the tax paid with respect to the corporation's Form 1120 filed for [REDACTED]. The taxpayers' [REDACTED] joint return bears a stamped notation that it was received by the Internal Revenue Service on [REDACTED].¹

According to your memorandum, the taxpayers did not amend their [REDACTED] return to pick up \$[REDACTED] in corporate income to reflect the fact that the corporation was belatedly awarded

¹ Your memorandum states that the 3 year statute of limitation expires on [REDACTED]. We assume that the taxpayers' [REDACTED] return was mailed on [REDACTED], and that the mailing was timely; i.e., within the period prescribed for filing the return, as extended.

status as a Subchapter S Corporation, nor did they report \$ [REDACTED] in capital gains realized by them in [REDACTED].

ISSUES

1. Whether the 6 year statute of limitations provided by I.R.C. § 6501(e) is applicable solely by virtue of the taxpayers' omission of \$ [REDACTED] in capital gains.

2. Whether we are bound to issue a statutory notice on or before [REDACTED] to protect the 3 year statute expiring after that date.

CONCLUSIONS

1. Assuming the accuracy of your determination that the taxpayers had \$ [REDACTED] in gross income and Schedule C gross receipts and further omitted \$ [REDACTED] in capital gains, the 6 year statute of limitations is applicable here.²

2. The 3 year statute of limitations will expire on [REDACTED] [REDACTED], if the taxpayers' [REDACTED] return was timely mailed to the Service on [REDACTED], or on [REDACTED], if the return was filed late, unless a statutory notice is filed on or before that date or an extension of the statute is executed by the taxpayer and the Service.

DISCUSSION AND LEGAL ANALYSIS

I.R.C. § 6501(e)(1) provides as follows:

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

I.R.C § 6501(e)(1)(A) further provides that,

In the case of a trade or business, the term "gross income" means the total of the amounts received

² In the absence of an opportunity to review your workpapers and other documents in the administrative file, this memorandum expresses no opinion as to the viability of your determination that the taxpayers had unreported capital gains income for [REDACTED] in any amount.

or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services;

It has long been held that the extended statute of limitations provided in the case of a 25% omission is limited to when specific receipts or accruals are left out of the computation of gross income. The Colony, Inc. v. Commissioner, 357 US 28, 78 (1958). Obviously, if the unreported Subchapter S income is ignored and only the unreported capital gains taken into account, there is a 25% omission. There is no basis for taking the unreported Subchapter S income into account as if it had been reported on the taxpayers' joint return.

It is also clear that the general 3 year statute will expire after [REDACTED] unless a statutory notice is issued or an extension obtained. Here, the decision to preserve the 3 year statute or rely on the 6 year statute is within the discretion of Examination. If you believe, upon further reflection, that the case will benefit from further audit work prior to issuing a final report, it would not be inappropriate to rely on the 6 year statute in this case.

SUMMARY AND CONCLUSION

This concludes our advice and recommendation. Please feel free to call Special Litigation Assistant Richard H. Gannon at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory ten day post review.

RICHARD H. GANNON
Special Litigation Assistant

Approved: _____

JOHN A. BECKER
Acting Assistant District Counsel